

# Family Farmer Bankruptcy - Chapter 12

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## Background

In tailoring chapter 12 to meet the economic realities of family farming, this law has eliminated many of the barriers that family farmers had faced when seeking to reorganize successfully under either chapter 11 or 13 of the Bankruptcy Code. For example, chapter 12 is more streamlined, less complicated, and less expensive than chapter 11, which is better suited to the large corporate reorganization. In addition, few family farmers find chapter 13 to be advantageous, because it was designed for wage earners who have smaller debts than those facing family farmers. In chapter 12, Congress sought to combine the features of the Bankruptcy Code which can provide a framework for successful family farm reorganizations. At the time of the enactment of chapter 12, Congress could not be sure whether chapter 12 relief for the family farmer would be required indefinitely. Accordingly, the law (which first provided that no chapter 12 cases could be filed after September 30, 1993) currently provides that no cases may be filed under chapter 12 after July 1, 2000.

The Bankruptcy Code provides that only a family farmer with "regular annual income" may file a petition for relief under chapter 12. 11 U.S.C. §§ 101(18), 109(f). The purpose of this requirement is to ensure that the debtor's annual income is sufficiently stable and regular to permit the debtor to make payments under a chapter 12 plan. Allowance is made under chapter 12, however, for situations in which family farmers may have income that is seasonal in nature. Relief under this chapter is voluntary; thus, only the debtor may file a petition under chapter 12.

Under the Bankruptcy Code, those eligible to file as "family farmers" fall into two categories: (1) an individual or individual and spouse and (2) a corporation or partnership. Those falling into the first category must meet each of the following four criteria as of the date the petition is filed in order to qualify for relief under chapter 12.

1. The individual or husband and wife must be engaged in a farming operation.
2. The total debts (secured and unsecured) of that farming operation must not exceed \$1.5 million.
3. Not less than 80% of the total debts which are fixed in amount must be related to the farming operation.
4. More than 50% of the gross income of the individual or the husband and wife for the receding tax year must have come from the farming operation.

In order for a corporation or partnership to fall within the second category of debtors eligible to file as "family farmers," the corporation or partnership must meet each of the following criteria as of the date of the filing of the petition.

1. More than one-half of the outstanding stock or equity in the corporation or partnership must be owned by one family or by one family and its relatives.
2. The family or the family and its relatives must conduct the farming operation.
3. More than 80% of the value of the corporate or partnership assets must be related to the farming operation.
4. The total indebtedness of the corporation or partnership must not exceed \$1.5 million.
5. Not less than 80% of the corporation's or partnership's total debts which are fixed in amount must come from the farming operation owned or operated by the corporation or partnership.
6. If the corporation issues stock, the stock cannot be publicly traded.

## How Chapter 12 Works

A chapter 12 case begins with the filing of a petition and several additional forms, such as schedules of assets and liabilities, a statement of financial affairs, a schedule of current income and expenditures, and a schedule of executory contracts and unexpired leases. Bankruptcy Rule 1007(b)(1). The petition and other forms are filed with the bankruptcy court serving the area where the individual lives or where the corporation or partnership debtor has its principal place of business or principal assets. The exact filing requirements in each jurisdiction are specified in local rules of court which can be obtained from the clerk's office. (Official Bankruptcy Forms can be purchased at a legal stationery store. They are not available from the court.) A husband and wife may file one joint petition. 11 U.S.C. § 302(a).

In order to complete the Official Bankruptcy Forms which make up the petition and schedules, the debtor will need to compile the following information:

1. A list of all creditors;
2. The source, amount, frequency, and reliability of the debtor's income;
3. A list of all of the debtor's property; and
4. A detailed list of the debtor's monthly farming and living expenses, *i.e.*, food, shelter, utilities, taxes, transportation, medicine, feed, fertilizer, etc.

When a husband and wife intend to file a single, joint petition, they should gather the above-detailed data for both spouses. Even when only one spouse files, however, the income and expenses of the non-filing spouse should be included in the petition and schedules, so that the court can assess accurately the debtor's financial responsibilities.

Currently, the courts are required to charge a \$200 filing fee. This fee should be paid in full upon filing or, with the court's permission, the fee for an individual debtor may be paid in up to four installments. Bankruptcy Rule 1006(b)(1). If a joint petition is filed, only one \$200 fee is charged.

Upon the filing of the petition, an impartial trustee is appointed by the court or the United States trustee to administer the case. 11 U.S.C. § 1202; 28 U.S.C. § 586(b). As in chapter 13, the trustee's primary responsibility is to act as a disbursing agent, receiving payments from debtors and making distributions

to creditors.

The filing of the petition also "automatically stays" most actions by creditors to collect money or property owed to them. 11 U.S.C. § 362. Creditors, by law, generally cannot initiate or continue any lawsuits, wage garnishments, or even telephone calls demanding payment. Creditors (whose identities and mailing addresses are provided by the debtor) will receive notice of the filing of the petition from the court.

The debtor must file a plan of repayment with the petition or within 90 days afterward, unless the court determines that the need for an extension is attributable to circumstances for which the debtor should not be held accountable. 11 U.S.C. § 1221. Plans, which must be approved by the court, provide for payments of fixed amounts to the trustee on a regular basis. The trustee then distributes the funds to creditors according to the terms of the plan.

There are three types of debt: secured, priority, and unsecured. Secured debts are those for which the creditor has the right to pursue specific pledged property upon default. Priority debts are those granted special status by the bankruptcy law, such as most taxes and the costs of the bankruptcy proceeding. Unsecured debts generally are characterized as those debts for which credit was extended based solely on the creditor's assessment of the debtor's future ability to pay.

The debtor's plan usually lasts three to five years. It must provide for payment in full to all priority creditors. 11 U.S.C. § 1222(a)(2). The plan need not provide that unsecured creditors be paid in full, as long as the debtor pays under the plan all projected "disposable income" over the three to five years that the plan is in effect and as long as the plan provides that unsecured creditors are to receive at least as much as they would receive if the debtor's nonexempt assets were liquidated under chapter 7. 11 U.S.C. § 1225. "Disposable income" is defined as income which is not reasonably necessary for the maintenance or support of the debtor or his/her dependents or for the payment of expenditures necessary for the continuation, preservation, and operation of the debtor's business. 11 U.S.C. § 1225(b)(2)(A) and (B).

Secured creditors must be paid at least as much as the value of the collateral pledged for the debt. One of the features of Chapter 12 is that, in certain circumstances, payments to secured creditors can continue longer than the three-to-five-year period the plan provides for payment to unsecured and priority creditors.

Approximately 20 to 35 days after the petition is filed, a "meeting of creditors" is held. The debtor must attend this meeting, at which creditors may appear and ask questions regarding the debtor's financial affairs and the proposed terms of the plan. 11 U.S.C. § 343; Bankruptcy Rule 4002. (If a husband and wife have filed a joint petition, both must attend the creditors' meeting.) The trustee will also attend the meeting and question the debtor. In order to preserve their independent judgment, bankruptcy judges are prohibited from attending meetings of creditors. 11 U.S.C. § 341(c). Any problems with the plan are typically resolved during or shortly after the creditors' meeting. Generally, problems may be avoided if the petition and plan are complete and accurate and the trustee has been consulted prior to the meeting.

Within 45 days after the filing of the plan, the presiding bankruptcy judge must determine at a "confirmation hearing" whether the plan is feasible and meets the standards for confirmation under the Bankruptcy Code. 11 U.S.C. §§ 1224 and 1225. Creditors may appear at the hearing and object to confirmation. While a variety of objections may be made, the typical arguments are that payments offered under the plan are less than creditors would receive if the debtor's assets were liquidated or that the plan does not commit all of the debtor's disposable income for the three-to-five-year period of the plan.

If the plan is confirmed by the bankruptcy judge, the trustee commences distribution of the funds the trustee has received from the debtor. If the plan is not confirmed, the funds paid to the trustee are returned to the debtor after deducting the trustee's percentage fee and any unpaid claim allowed for administrative expenses. 11 U.S.C. § 1226(a).

On occasion, changed circumstances will affect a debtor's ability to make payments or a debtor may inadvertently have failed to list all creditors. In such instances, the plan may be modified either before or

after confirmation. 11 U.S.C. §§ 1223 and 1229.

## **Making the Plan Work**

Once the court confirms the plan, it is incumbent upon the debtor to make the plan succeed. The debtor must make regular payments to the trustee. Further, while confirmation of the plan entitles the debtor to retain property as long as payments are made, 11 U.S.C. § 1227(b), the debtor should not incur any significant new credit obligations without consulting the trustee, because they may impact upon the successful execution of the plan. In any event, failure to make the plan payments may result in dismissal of the case. 11 U.S.C. § 1208(c). In addition, the court may dismiss the case or convert the case to a liquidation case under chapter 7 of the Bankruptcy Code upon a showing that the debtor has committed fraud in connection with the case. 11 U.S.C. § 1208(d).

## **The Chapter 12 Discharge**

As is the case under chapter 13, upon successful completion of all payments under a chapter 12 plan, the debtor will receive a "discharge" which extinguishes the debtor's obligation to pay any unsecured debts that were included in the plan, even though they may not have been paid in full. 11 U.S.C. § 1228. After the discharge has been granted, those creditors whose claims were provided for in full or in part under the plan no longer may initiate or continue any legal or other action against the debtor to collect the discharged obligations.

Certain categories of debts are not discharged in chapter 12 proceedings. 11 U.S.C. § 1228(a). Those categories include debts for alimony and child support; money obtained through filing false financial statements; debts for willful and malicious injury to person or property; debts for death or personal injury caused by the debtor's operation of a motor vehicle while the debtor was intoxicated; and debts from fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny. In fact, the discharge is more limited in chapter 12 than it is in a chapter 13 case. The bankruptcy law regarding the scope of a chapter 12 discharge is complex, however, and debtors should consult competent legal counsel in this regard prior to filing. Those debts which will not be discharged should be paid in full under a plan. With respect to secured obligations, those debts may be paid beyond the end of the plan payment period and, accordingly, are not discharged.

## **Chapter 12 Hardship Discharge**

If payments under a plan are not completed due to circumstances for which the family farmer "should not justly be held accountable," 11 U.S.C. § 1228(b)(1), and other statutory criteria have been met, a family farmer may be excused from completing payments under a plan of reorganization. If the court finds that such circumstances exist and that unsecured creditors already have received at least what they would have received if the debtor's estate had been liquidated under chapter 7 of the Bankruptcy Code, the bankruptcy court may grant the debtor a discharge of all unsecured debts provided for in the plan or disallowed by the court, with the exception of those types of debts which are excepted from discharge. Injury or illness that precludes employment sufficient to fund even a modified plan may serve as the basis for a discharge under section 1228(c). A discharge granted under section 1228(c) is often referred to as a "hardship discharge."